



DEPARTMENT OF THE TREASURY
Internal Revenue Service
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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4945.04-06

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

SE:T:EO:RA:T:1

Legend:

A =

M =

University =

\$x =

Date Y =

Dear

This is in reply to your ruling request regarding the proper treatment under sections 507, 4940, 4941, 4944 and 4945 of the Internal Revenue Code ("Code") of a transfer of assets and liabilities from you to a newly created organization.

FACTS

You were formed by A for the purpose of providing educational opportunities for disadvantaged inner-city children. You have been recognized as an organization described in section 501(c)(3) of the Code and classified as a private foundation under section 509.

In the past, you have sponsored a wide range of programs including after school and summer programs, mentoring, tutoring, school-day academic support, family outreach, scholarships, social work and counseling services. In addition, you made grants that further your charitable objectives. Several years ago, you made a \$x pledge to University for various purposes. Currently, half of the pledge remains unpaid.

You now plan to focus on a narrower range of programs that provide education to disadvantaged inner-city children and support to their families. Consequently, you plan to transfer the pledge made to University, along with additional assets required to carry on other charitable objectives that do not directly further your new, narrower, purpose, to M, a new private foundation created by A (the "Transfer"). The Transfer would consist of more than 25% of your assets. M has been recognized as an organization described in section 501(c)(3) of the Code and classified as a private foundation under section 509. The Transfer will be accompanied by an assumption agreement that ensures M fulfills its obligations to the University and you will exercise expenditure responsibility with regard to the transferred assets.

You have recently broadened your public support base through additional fundraising. Consequently, on Date Y you filed advance notice of your intent to terminate your private foundation status by operating as a public charity for sixty months. You have received a favorable advance ruling that you will be described in section 509(a)(1) of the Code at the end of that period.

Based on the above facts, you request the following rulings:

1. The Transfer will not adversely affect the tax-exempt status of either you or M under section 501(c)(3) of the Code.
2. The Transfer will qualify as a transfer under section 507(b)(2) of the Code.
3. The Transfer will not operate to terminate your status under section 507(a) of the Code, and therefore will not subject you to termination tax under section 507(c).
4. The Transfer will not adversely affect the termination of your private foundation status or your qualification as a public charity under section 507(b)(1)(B) of the Code.
5. The Transfer will not adversely affect the advance ruling on your public charity status.
6. The basis of any assets received in the Transfer by M will be your basis in the assets for purposes of section 4940(c)(4)(B) of the Code.
7. The Transfer will not constitute an act of self-dealing under section 4941 of the Code for you or your disqualified persons.
8. The Transfer will not constitute an investment that jeopardizes your exempt purposes under section 4944 of the Code.
9. The Transfer will not constitute a taxable expenditure under section 4945 of the Code, provided appropriate expenditure responsibility requirements are satisfied under section 4945(d) and (h) during the remainder of your sixty month termination period.
10. You will not be required to continue to exercise expenditure responsibility over the assets transferred to M under section 4945(d) and (h) of the Code upon the successful completion of your sixty month termination period under section 507(b)(1)(B).
11. The reasonable and necessary expenses in making the Transfer, including those incurred in connection with this ruling, will not constitute a taxable expenditure under section 4945 of the Code.

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational and other exempt purposes, provided that no part of its net earnings inures to the benefit of any private shareholder or individual.

Section 507(a)(1) of the Code states that the status of any organization as a private foundation shall be terminated only if it notifies the Secretary of its intent to terminate or there have been either willful repeated acts or a willful and flagrant act giving rise to liability for tax under Chapter 42 and the Secretary notifies the organization that it is liable for termination tax under section 507 and either the organization pays the tax imposed by section 507(c) or the tax is abated under section 507(g).

Section 507(b)(1)(B) of the Code states that the status of any organization as a private foundation may be terminated if the private foundation notifies the Secretary of its intent to terminate its private foundation status by operating as a public charity, and in fact operates as a public charity for its termination period.

Section 507(b)(2) of the Code provides that in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 4941(a) of the Code imposes a tax on acts of self-dealing between a disqualified person and a private foundation.

Section 4944 of the Code imposes a tax upon a private foundation which invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.

Section 4945(a) of the Code imposes an excise tax on the taxable expenditures made by a private foundation.

Section 4945(d)(4) provides, in part, that the term "taxable expenditure" means any amount paid or incurred as a grant to an organization (other than a public charity described in section 509(a)(1), (2), or (3)), unless the private foundation exercises expenditure responsibility in accordance with section 4945(h).

Section 4945(h) of the Code provides that expenditure responsibility means the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that the grant is spent solely for the purpose for which it was made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Secretary or his delegate.

Section 1.507-1(b)(7) of the Income Tax Regulations provides that neither a transfer of all of the assets of a private foundation, nor a significant disposition of assets (as defined in section 1.507-3(c)(2)) by a private foundation (whether or not any portion of such disposition of assets is made to another private foundation), shall be deemed to result in a termination of the transferor private foundation unless the transferor private foundation elects to terminate pursuant to section 507(a)(1) or section 507(a)(2) of the Code.

Section 1.507-2(b)(2) of the regulations states that a private foundation's notification that it is commencing a termination under section 507(b)(1)(B) of the Code will not be treated as a notification described in section 507(a) and no termination tax will be incurred under section 507(c).

Section 1.507-2(e)(1) of the regulations state that an organization which files the notification under section 507(b)(1)(B) of the Code may obtain an advance ruling that it can be expected to satisfy the requirements thereof.

Section 1.507-2(f)(1)(i) of the regulations provides, in part, that in the event that an organization satisfies the requirements of section 507(b)(1)(B) for termination of its private foundation status by the end of the 12-month period or during the continuous 60-month period, such organization shall be treated for such entire 12-month or 60-month period in the same manner as an organization described in section 509(a)(1), (2), or (3).

Section 1.507-3(a)(8)(ii)(a) of the regulations provides that assets transferred in a transaction described in section 507(b)(2) of the Code will have the same basis and holding period for the transferee as they did for the transferor.

Section 1.507-3(c)(1) of the regulations provides that for purposes of section 507(b)(2) of the Code the terms "other adjustment, organization or reorganization," shall include a significant disposition of assets.

Section 1.507-3(c)(2) of the regulations provides that the term "significant disposition of assets" includes any disposition by a foundation in a taxable year to one or more other private foundations which is 25 percent or more of the fair market value of the net assets of the distributing foundation at the beginning of the taxable year.

Section 1.507-3(d) of the regulations provides that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in section 507(b)(2) of the Code, such transferor foundation will not have terminated its private foundation status under section 507(a)(1).

Section 1.507-3(f) of the regulations provides that, if during an organization's sixty month termination period under section 507(b)(1)(B) of the Code, such organization makes a significant disposition of assets to a private foundation, the transfer will be treated as a section 507(b)(2) transfer rather than as a grant or contribution from a public charity.

Section 53.4945-6(b)(2) of the Foundation and Similar Excise Tax Regulations provides that legal, administrative and other expenses incurred by a private foundation in a good faith belief that they are reasonable and consistent with ordinary care and prudence will not constitute taxable expenditures. The regulations further provide that the determination of whether an expenditure is unreasonable depends upon the facts and circumstances of a particular case.

Section 53.4946-1(a)(8) of the regulations indicates that for purposes of section 4941 of the Code, the term "disqualified person" does not include any organization described in section 501(c)(3).

Rev. Rul. 2003-13, 2003-4 I.R.B. 305 provides that a transfer from a private foundation of all its assets to one or more organizations described in section 509(a) of the Code does not constitute an investment for purposes of section 4944.

ANALYSIS

RULING 1: The Transfer will not adversely affect the tax-exempt status of either you or M under section 501(c)(3) of the Code.

To be exempt under section 501(c)(3) of the Code, an organization must be organized and operated exclusively for exempt purposes. You are organized and operated to further exempt charitable and educational purposes. The assets transferred to M will be used to further charitable and educational purposes. Therefore, the Transfer is an activity in furtherance of your exempt purposes and will not adversely affect your exempt status.

The Transfer will require M to fulfill your pledge to the University. Fulfilling this obligation is in furtherance of M's charitable and educational purposes because it will help to support education. Therefore, the Transfer and its accompanying obligation will not adversely affect the tax exempt status of M.

RULING 2: The Transfer will qualify as a transfer under section 507(b)(2) of the Code.

Section 507(b)(2) of the Code applies to transfers from one private foundation to another "pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization." Section 1.507-3(c)(1) of the regulations provides that section 507(b)(2) applies to a significant disposition of assets. A significant disposition of assets is defined in section 1.507-3(c)(2) as a transfer of more than 25 percent of one private foundation's assets to another private foundation. Section 1.507-3(f) provides that, if, during an organization's sixty month termination period under section 507(b)(1)(B), such organization makes a significant disposition of assets to a private foundation the transfer will be treated as a section 507(b)(2) transfer rather than as a grant or contribution from a public charity.

The Transfer includes transferring more than 25 percent of your assets to M. M is a private foundation. You are a private foundation within the sixty month termination period described in section 507(b)(1)(B) of the Code. Therefore, the Transfer will be treated as a transfer under section 507(b)(2) of the Code and not as a grant or contribution from a public charity.

RULING 3: The Transfer will not operate to terminate your status under section 507(a) of the Code, and therefore will not subject you to termination tax under section 507(c).

Section 1.507-1(b)(6) of the regulations states that a transfer of assets under section 507(b)(2) of the Code does not constitute a termination of a transferor foundation's private foundation status under section 507(a). As stated above, the Transfer will qualify as a transfer of assets under section 507(b)(2), therefore the Transfer will not operate to terminate your status as a private foundation or subject you to termination tax under section 507(c).

RULING 4: The Transfer will not adversely affect the termination of your private foundation status or your qualification as a public charity under section 507(b)(1)(B) of the Code.

The determination of whether an organization qualifies as a public charity depends upon the organization's sources of support. Transfers of assets by the organization do not effect whether the organization meets the requirements of being a public charity instead of a private foundation. Therefore, the Transfer will have no effect on your termination of private foundation status and becoming a public charity under section 507(b)(1)(B) of the Code.

RULING 5: The Transfer will not adversely affect the advance ruling on your public charity status.

As discussed above in Ruling 4, the Transfer will not adversely affect the advance ruling on your public charity status because a transfer of assets does not affect whether an organization meets the test for being classified as a public charity as opposed to being a private foundation.

RULING 6: The basis of any assets received in the Transfer by M will be your basis in the assets for purposes of section 4940(c)(4)(B) of the Code.

Section 1.507-3(a)(8)(ii)(a) of the regulations provides that assets transferred as described in section 507(b)(2) of the Code will have the same basis in the hands of the transferee as they did in the hands of the transferor for purposes of 4940(c)(4)(B). The assets transferred by you to M are pursuant to a section 507(b)(2) transfer, therefore M's basis in the assets will be the same as yours for the purposes of 4940(c)(4)(B).

RULING 7: The Transfer will not constitute an act of self-dealing under section 4941 of the Code for you or your disqualified persons.

Section 4941 of the Code imposes an excise tax on acts of self-dealing between a private foundation and its disqualified persons, as the term is defined in section 4946. Section 53.4946-1(a)(8) of the regulations provides that for the purposes of section 4941, disqualified persons do not include organizations described in section 501(c)(3).

M is not a disqualified person with respect to you for purposes of section 4941 of the Code because it is an organization described in section 501(c)(3). Therefore, the Transfer will not constitute an act of self-dealing because it is not a transaction between a private foundation and a disqualified person.

RULING 8: The Transfer will not constitute an investment that jeopardizes your exempt purposes under section 4944 of the Code.

Section 4944 of the Code imposes a tax upon a private foundation which invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes. Revenue Ruling 2003-13 states that a transfer from a private foundation of all of its assets to one or more organizations described in section 509(a) does not constitute an investment for purposes of section 4944.

You are transferring assets to M and do not retain any interest in those assets. While the

Transfer is not a transfer of all of your assets, it has the same character as the transfer described in Revenue Ruling 2003-13. We conclude that section 4944 of the Code does not apply to the Transfer because it is not an investment.

RULING 9: The Transfer will not constitute a taxable expenditure under section 4945 of the Code, provided appropriate expenditure responsibility requirements are satisfied under sections 4945(d) and (h) during the remainder of your sixty month termination period.

Section 4945(a) of the Code imposes an excise tax on each taxable expenditure of a private foundation. A taxable expenditure is defined in section 4945(d) as an amount paid or incurred to, among other things, an organization other than an organization described in section 509(a)(1), (2), or (3) or section 4940(d)(2), unless the distributing foundation exercises expenditure responsibility with respect to the amount paid.

M is an organization described in section 501(c)(3) of the Code, however it does not meet the requirements of sections 509(a)(1), (2), or (3). Furthermore, M is not an organization described under section 4940(d)(2). Therefore, you must exercise expenditure responsibility over the assets transferred to M pursuant to the Transfer during the remainder of your sixty month termination period in order to preclude the Transfer being classified as a taxable expenditure. See section 4945(h); section 53.4945-5(b) of the regulations.

RULING 10: You will not be required to continue to exercise expenditure responsibility over the Transfer under section 4945(d) and (h) of the Code upon the successful completion of your sixty month termination period under section 507(b)(1)(B).

Section 1.507-2(f)(1)(i) of the regulations provides that when a private foundation satisfies the requirements for termination under section 507(b)(1)(B) of the Code, any actions it took during the 60 month termination period will be treated as those of an organization described in sections 509(a)(1), (2), or (3) of the Code. Organizations described in section 509(a)(1) are not required to exercise expenditure responsibility under sections 4945(d) and (h).

If you meet the requirements for termination under section 507(b)(1)(B) of the Code and become a public charity described in section 509(a)(1), the Transfer will be treated as made by an organization described in sections 509(a)(1) because it was made during your 60 month termination period. Therefore, you will not be required to exercise responsibility over the Transfer if you successfully terminate your private foundation status and become an organization described in section 509(a)(1).

RULING 11: The reasonable and necessary expenses in making the Transfer, including those incurred in connection with this ruling, will not constitute taxable expenditure under section 4945 of the Code.

Under section 53.4945-6(b)(2) of the regulations, legal, administrative and other expenses incurred by a private foundation in a good faith belief that they are reasonable and consistent with ordinary care and prudence will not constitute taxable expenditures. The determination whether an expenditure is unreasonable depends upon the facts and circumstances of a particular case.

The expenses incurred in making the Transfer, including those incurred in connection with this letter ruling, constitute legal, administrative, and other expenses for purposes of section 53.4945-6(b)(2) of the regulations. Therefore, your payment of these fees, if incurred with a good faith belief that they are reasonable, will not constitute a taxable expenditure under section 4945 of the Code.

RULINGS

1. The Transfer will not adversely affect the tax-exempt status of either you or M under section 501(c)(3) of the Code.
2. The Transfer will qualify as a transfer under section 507(b)(2) of the Code.
3. The Transfer will not operate to terminate your status under section 507(a) of the Code, and therefore will not subject you to termination tax under section 507(c).
4. The Transfer will not adversely affect the termination of your private foundation status or your qualification as a public charity under section 507(b)(1)(B) of the Code.
5. The Transfer will not adversely affect the advance ruling on your public charity status.
6. The basis of any assets received in the Transfer by M will be your basis in the assets for purposes of section 4940(c)(4)(B) of the Code.
7. The Transfer will not constitute an act of self-dealing under section 4941 of the Code for you or your disqualified persons.
8. The Transfer will not constitute an investment that jeopardizes your exempt purposes under section 4944 of the Code.
9. The Transfer will not constitute a taxable expenditure under section 4945 of the Code, provided appropriate expenditure responsibility requirements are satisfied under section 4945(d) and (h) during the remainder of your sixty month termination period.
10. You will not be required to continue to exercise expenditure responsibility over the assets transferred to M under section 4945(d) and (h) of the Code upon the successful completion of your sixty month termination period under section 507(b)(1)(B).
11. The reasonable and necessary expenses in making the Transfer, including those incurred in connection with this ruling, will not constitute a taxable expenditure under section 4945 of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Steven Grodnitzky
Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437